

Inflation Inflated: Part 1 – The Consumer Outlook



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About L.E.K. Consulting

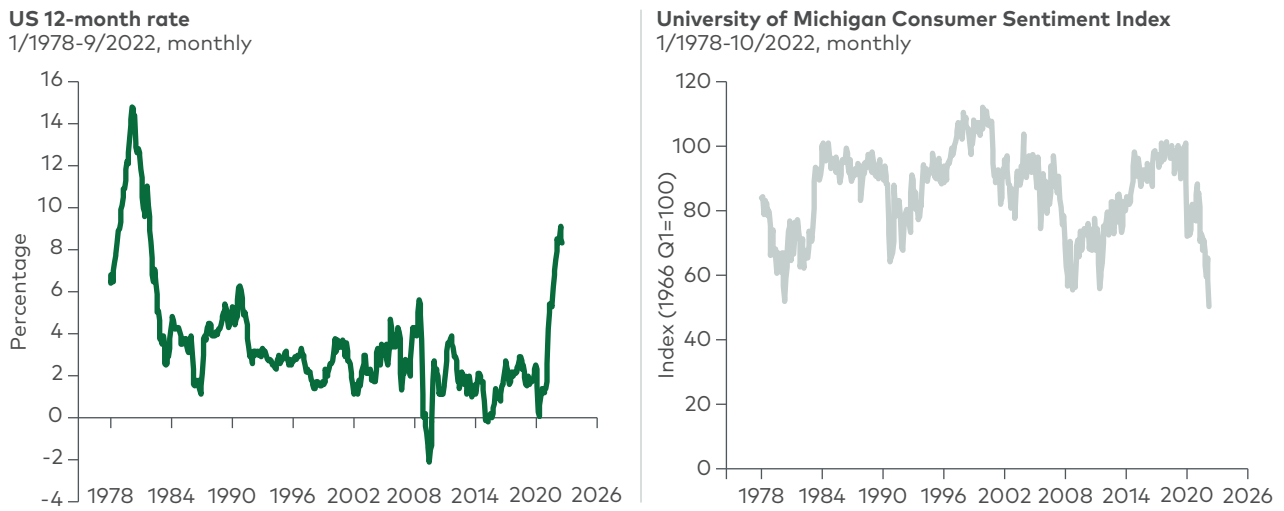
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Understanding how consumers are responding to inflation

With U.S. inflation at its highest level in more than 40 years, consumer sentiment has fallen close to an all-time low. Against this backdrop of unprecedented economic conditions, L.E.K. Consulting in October 2022 conducted a survey to learn more about how the country's consumers have been changing their behaviors — and how they plan to change them going forward.









Figure 1
Monthly inflation rate and consumer sentiment index since 1978



Source: University of Michigan; Bureau of Labor Statistics





L.E.K. surveyed more than 2,500 consumers across a range of income levels and generational segments to understand who, exactly, is being impacted by the rise in inflation and to what degree. It also set out to ascertain which of 17 different consumer categories are being impacted the most and how consumers' behavior in relation to those categories is changing. More specifically, it sought to identify the categories consumers are most likely to cut or trade down in while inflation stays high, as well as those they're most likely to return to once inflation starts to abate.

Figure 2
L.E.K. 2022 US Inflation Study Methodology

Key issues				
 <p>1 Who is impacted by inflation?</p>	<ul style="list-style-type: none"> How has inflationary impact varied across key consumer demographics of age groups versus income ranges? 	 <p>Conducted October 2022</p>	 <p>US consumers</p>	
 <p>2 Which categories are most affected?</p>	<ul style="list-style-type: none"> How does inflation affect the way consumers interact with discretionary and non-discretionary categories? Do key consumer demographics view inflation across categories differently? 	 <p>2,500+ respondents</p>	 <p>Balanced to general population</p>	
<p>3 How has consumer behavior changed?</p>			<p>17 categories examined</p>	
 <p>How has consumer behavior changed?</p>	<ul style="list-style-type: none"> How has inflation caused consumer behavior to change? In which categories are consumers more or less likely to change their behavior? How do behavioral changes differ by category? 	<ul style="list-style-type: none"> Apparel, accessories and footwear Beauty and personal care Consumer electronics Daily use household items Fitness Food and beverage Gambling Gasoline, automobile parts and upgrades Health and wellness products Home improvement, furniture and furnishings Leisure products and entertainment Pet products Rent Restaurants and foodservice Sporting goods/outdoor Travel and transport Utilities 		
 <p>4 Which categories are prioritized moving forward?</p>	<ul style="list-style-type: none"> If prices continue to rise, which categories are most vulnerable to being cut? When prices stabilize, to which categories are consumers most excited to return? 			

Our survey shows how consumers in each income segment are being affected, with the greatest impact being on lower-income households. Additionally, the results show the categories where consumers are willing to absorb the cost increases, such as utilities, rent and motor vehicles, and where they're not, leading to either trade-out or trade-down behaviors in those categories.

Figure 3
Critical trends and issues impacting consumers today

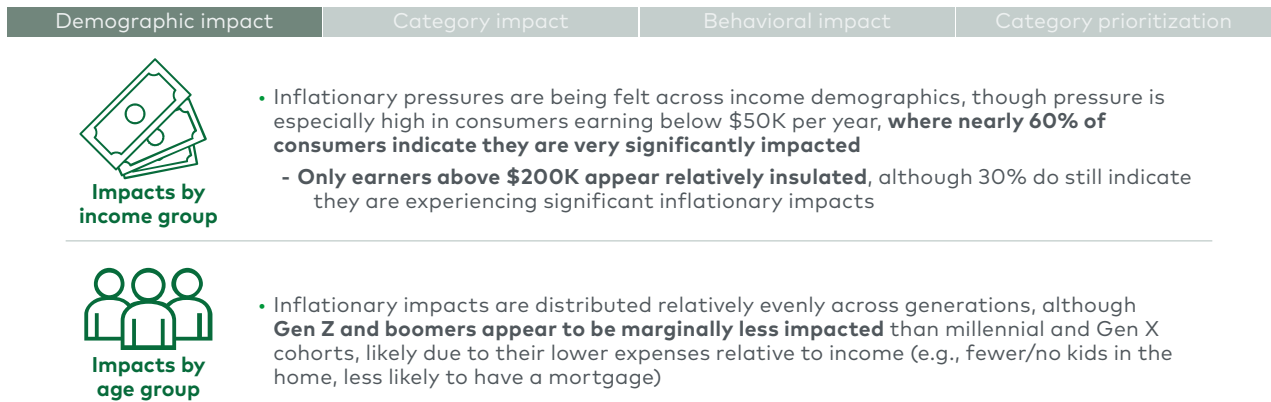
1 Who is impacted? 	2 Which categories are most affected? 	3 How has consumer behavior changed? 	4 Which categories are prioritized moving forward? 
<p>More than 50% of earners below \$150K indicate being "very significantly impacted" by inflation</p> <ul style="list-style-type: none"> • <\$50K per year ~60% • \$50K-\$150K ~45%-50% • \$150K-\$200K ~40% • >\$200K ~30% <p>(Percentage of consumers selecting 6 or 7 on a 1-7 scale)</p>	<p>Impacts are most felt within nondiscretionary categories used every day</p> <p>>55% of respondents report significant impacts in auto and F&B</p>	<p>Whether consumers absorb price changes is usually aligned to whether the category is discretionary</p> <p>Percentage of consumers absorbing prices</p> <ul style="list-style-type: none"> • Utilities ~60% • Rent ~45%-50% • Gasoline, automobile parts and upgrades ~40% • Pet ~30% <p>Percentage of consumers not absorbing prices</p> <ul style="list-style-type: none"> • Apparel ~85%-90% • Gambling ~85%-90% • Leisure ~85%-90% • Home improvement ~85% • Sporting goods ~85% 	<p>What categories are prioritized to be cut if prices continue rising?</p> <p>Consumers forecast that they would be most likely to cut back on eating out, gambling and travel (~40% of respondents selecting as the first priority to be cut)</p> <p>(Consumers who reported increased spending in a category were shown a maximum of five categories to compare preferences)</p>
<p>Millennials and Gen X consumers report experiencing greater financial impacts than lower-earning Gen Z counterparts</p> <ul style="list-style-type: none"> • Gen Z ~45% • Millennial ~50%-55% • Gen X ~50%-55% • Boomer ~45% <p>(Percentage of consumers selecting 6 or 7 on a 1-7 scale)</p>	<p>Impacts are generally distributed in accordance with wealth</p> <p>The average delta between least and most impacted income groups is ~14%, but it is 2%-8% for notable exceptions such as restaurants, rent and home improvement</p>	<p>Relative to their lower incomes, Gen Z appears less likely to modify behavior within restaurant and apparel categories</p>	<p>What categories are prioritized for return when prices stabilize?</p> <p>Consumers report the greatest excitement about returning to preferred food and beverage products, rental units, daily household items, and travel options (>40% selecting first prioritization across categories)</p> <p>(Consumers who reported increased spending in a category were shown a maximum of five categories to compare preferences)</p>
<p>Boomers are generally the least impacted age cohort</p> <p>However, Gen Z indicates incrementally lower impact from inflation within F&B and restaurants</p>			

F&B=food and beverage
Source: L.E.K. research and analysis

Who is impacted by inflation

While the impact of inflation is being felt across generations and income levels, certain groups are feeling it more than others. The greatest impact is being felt by millennials and Generation X, while Generation Z and boomers are slightly less affected.

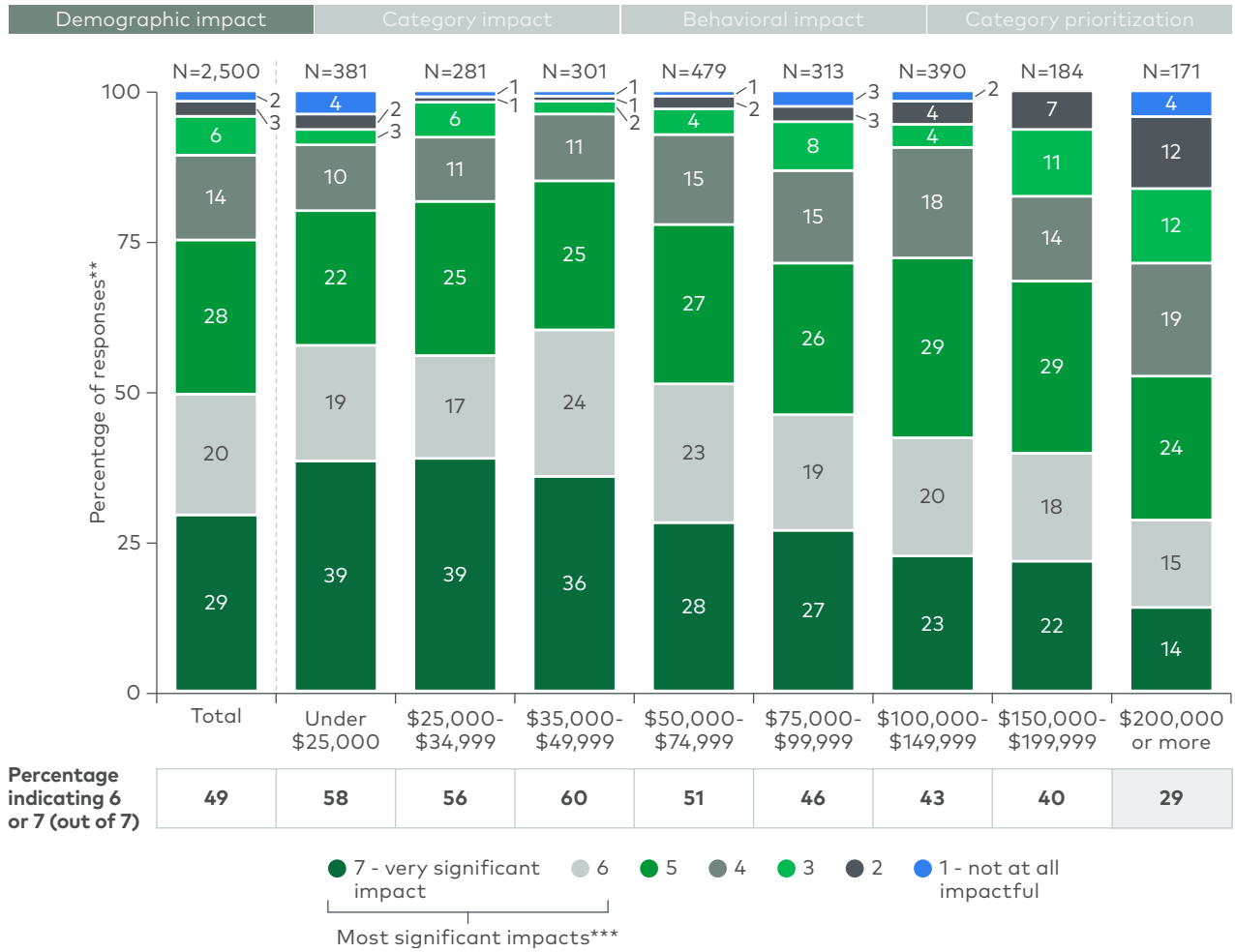
Figure 4
Inflation’s impact on key demographic groups



Source: L.E.K. research and analysis

Inflationary challenges are especially acute for consumers earning below \$50,000/year, of whom nearly 60% report being significantly impacted. And while those earning more than \$200,000/year appear relatively insulated, 30% of them also report experiencing significant inflationary impacts — inflation just may not be impacting their spending as directly. Meanwhile, even though the impacts of inflation are distributed relatively evenly across generations, more than 50% of millennials and Gen Xers — many of whom are juggling children and mortgages — are feeling the pinch, whereas Gen Z and boomers are slightly less affected.

Figure 5
Inflation impact by income demographic



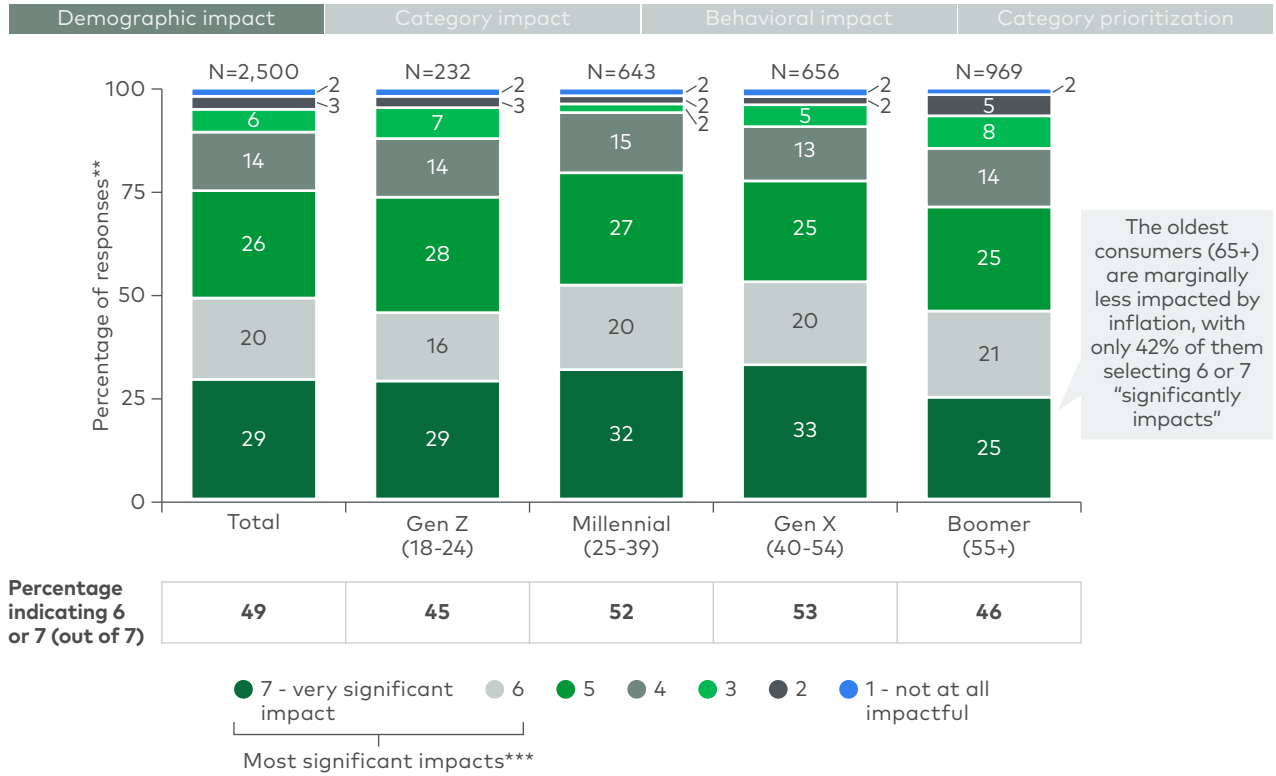
*Survey questions: Which of the following ranges best describes your total annual household income before taxes last year (2021)? On a scale of 1 to 7, how impactful is inflation on your day-to-day life? Please answer on a scale of 1 to 7, where "1" is "not at all impactful" and "7" is "very significant impact" (Select one)

**Percentages may not add to 100 due to rounding

***Defined as rating a "6" or higher

Source: L.E.K. survey and analysis

Figure 6
Inflation impact, by age cohort



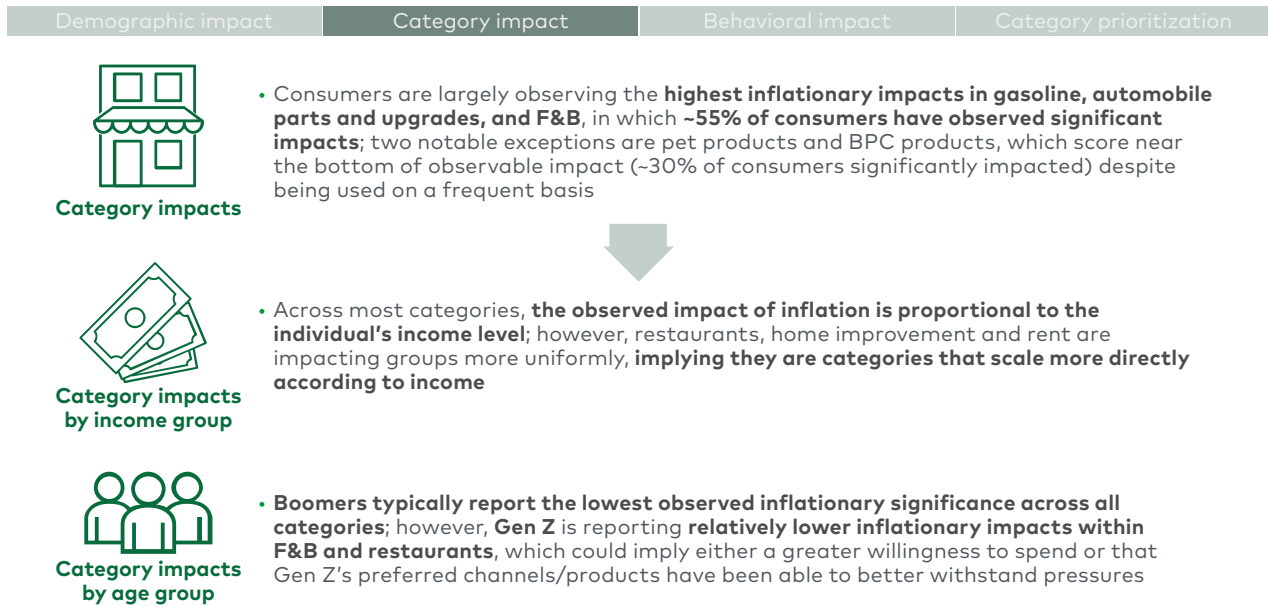
*Survey questions: What is your age? On a scale of 1 to 7, how impactful is inflation on your day-to-day life? Please answer on a scale of 1 to 7, where "1" is "not at all impactful" and "7" is "very significant impact" (Select one)
 **Percentages may not add to 100 due to rounding
 ***Defined as rating a "6" or higher
 Source: L.E.K. survey and analysis

The impact of inflation across categories

Unsurprisingly, consumers see the biggest inflationary impacts on the products and services they use the most, often daily – namely those related to their use of motor vehicles, such as gas, as well as food and beverages. That said, the impact on high-touch product categories like pets and beauty and personal care is not as high.

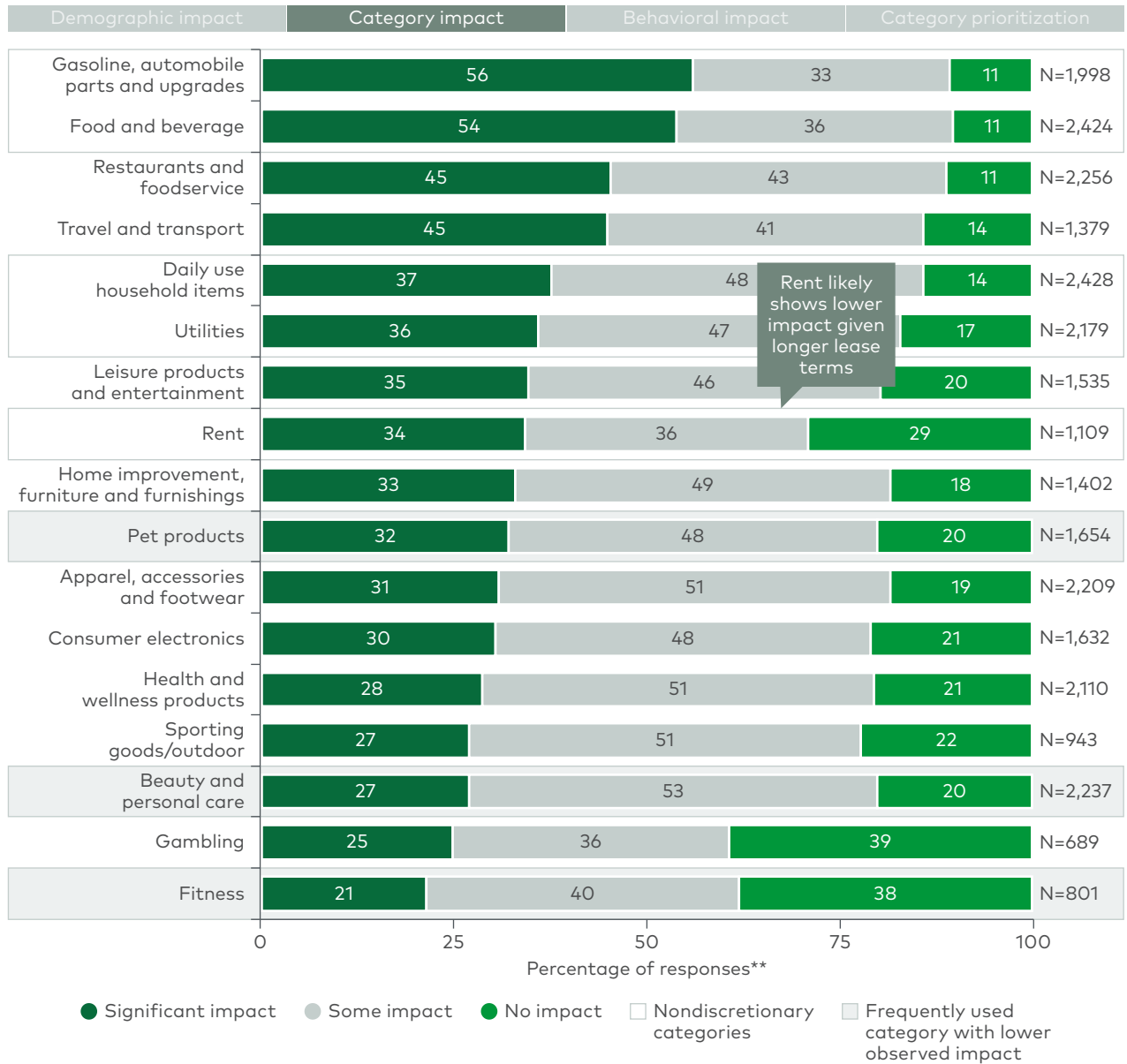
Figure 7

Inflation impact by categories



BPC=beauty and personal care; F&B=food and beverage
 Source: L.E.K. research and analysis

Figure 8
Inflationary impact on key products

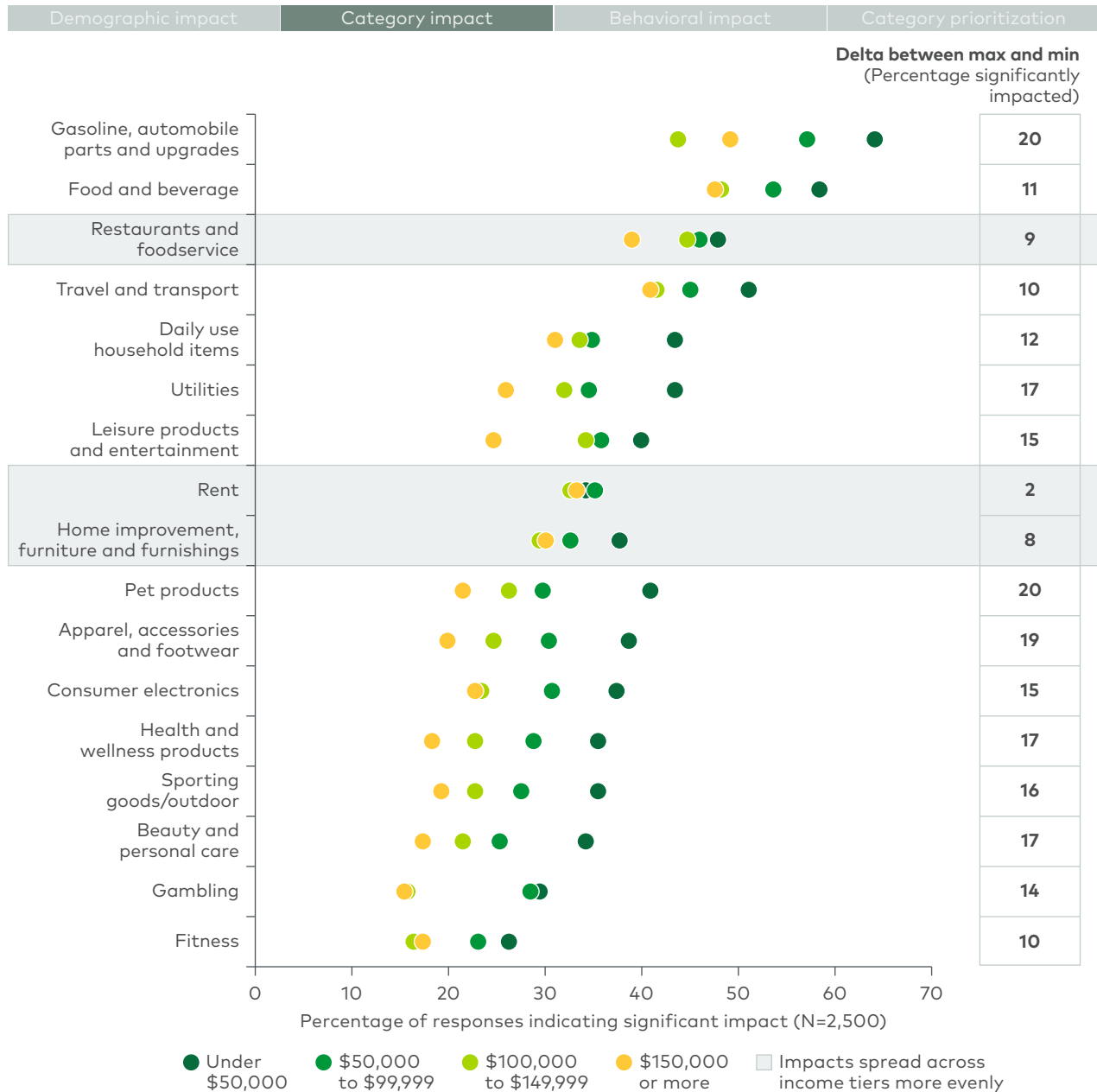


*Survey question: How much has inflation impacted the following products you have purchased in the past 12 months?
 **Percentages may not add to 100 due to rounding
 Source: L.E.K. survey and analysis

Across almost all categories, the perceived impact of inflation is proportional to income level in all but three categories – rent, restaurants and foodservice, and home improvement. The perceived impact of inflation in these three categories is nearly the same for all income groups, suggesting that these are areas where spending scales directly to income.

Meanwhile, the impact of inflation is typically reduced across older demographics, including boomers (and retirees). Notably, Gen Z reports relatively lower inflationary impacts within the food and beverage and restaurants and foodservice categories, which could mean one of two things: Either members of that generation are simply

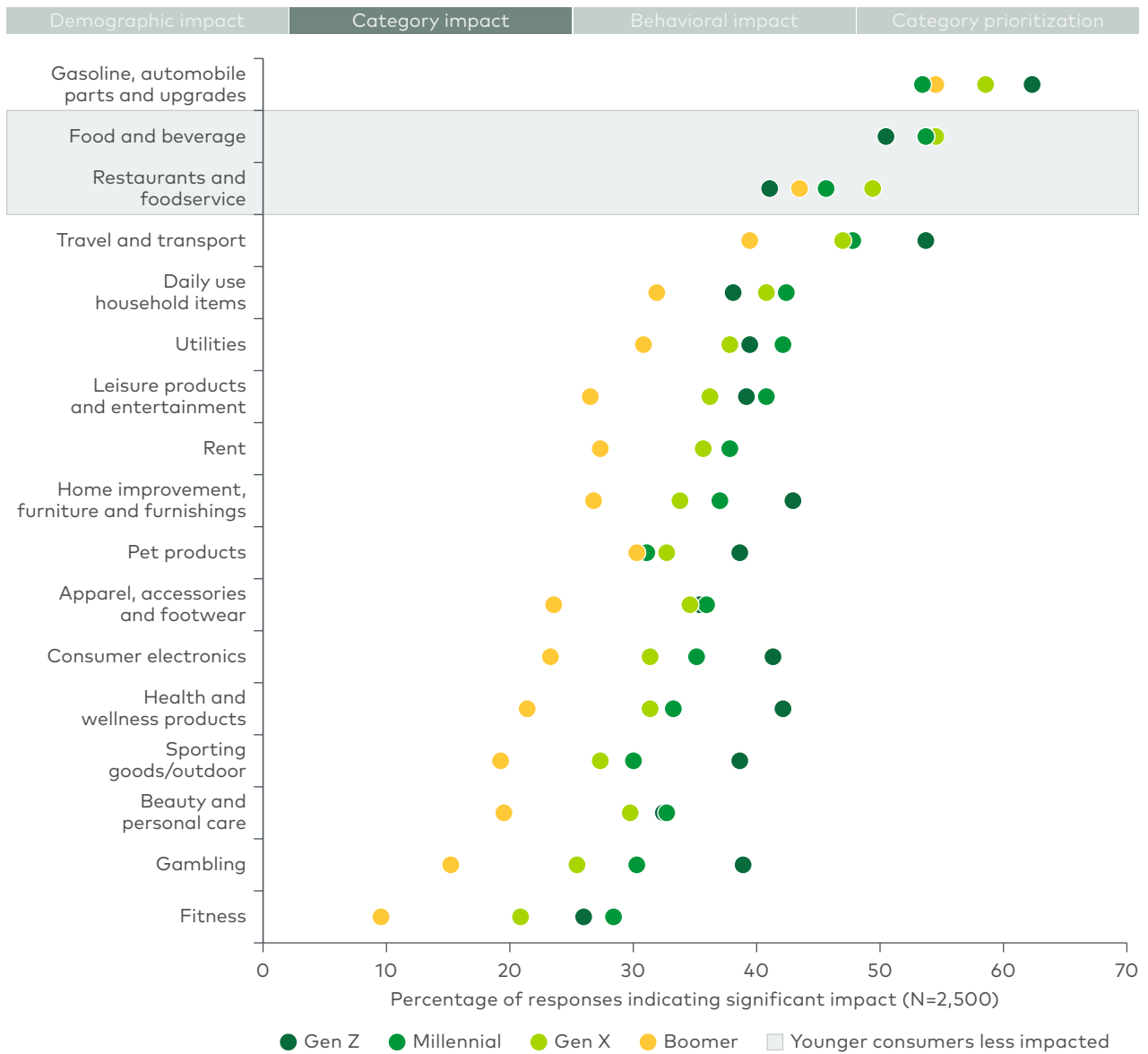
Figure 9
Inflationary impact on key products, by income



*Survey question: How much has inflation impacted the following products you have purchased in the past 12 months?
Source: L.E.K. survey and analysis

more willing to spend money on those categories, or their preferred channels and/or the products and services they pay for in those categories have been better able to withstand inflationary pressures.

Figure 10
Inflationary impact on key products, by age

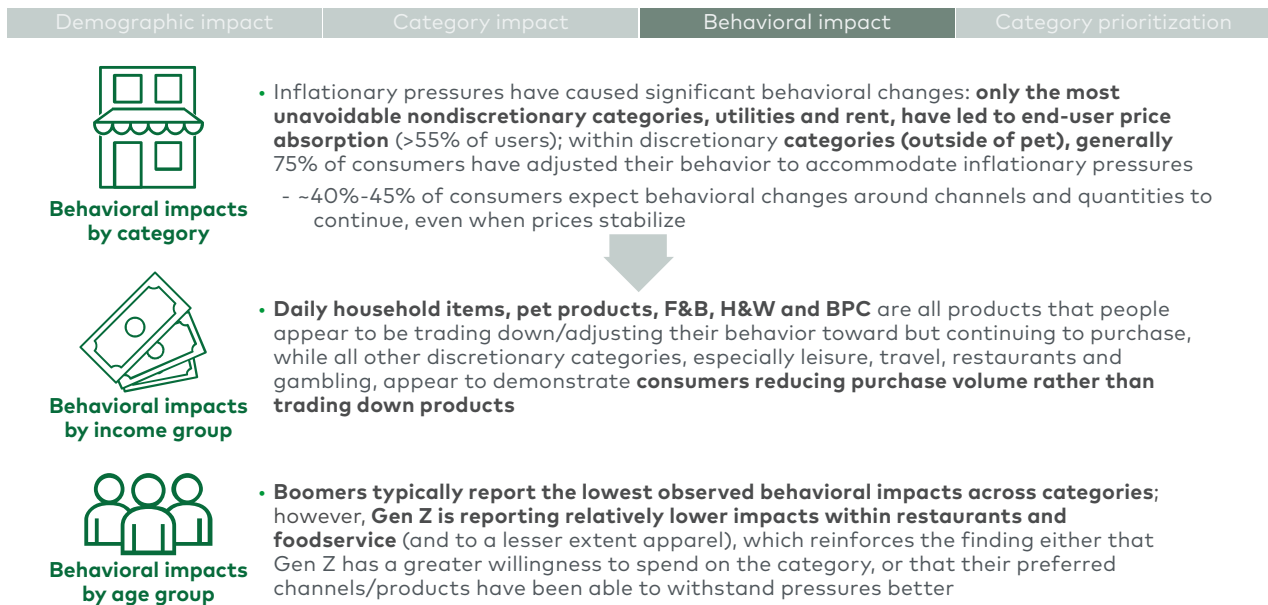


*Survey question: How much has inflation impacted the following products you have purchased in the past 12 months?
Source: L.E.K. survey and analysis

How inflation is impacting behavior

Broadly speaking, inflation is having an undeniable impact on consumer behavior. Outside of rent and utilities, anywhere from 50% to 85% of consumers have changed their purchase behaviors due to inflation.

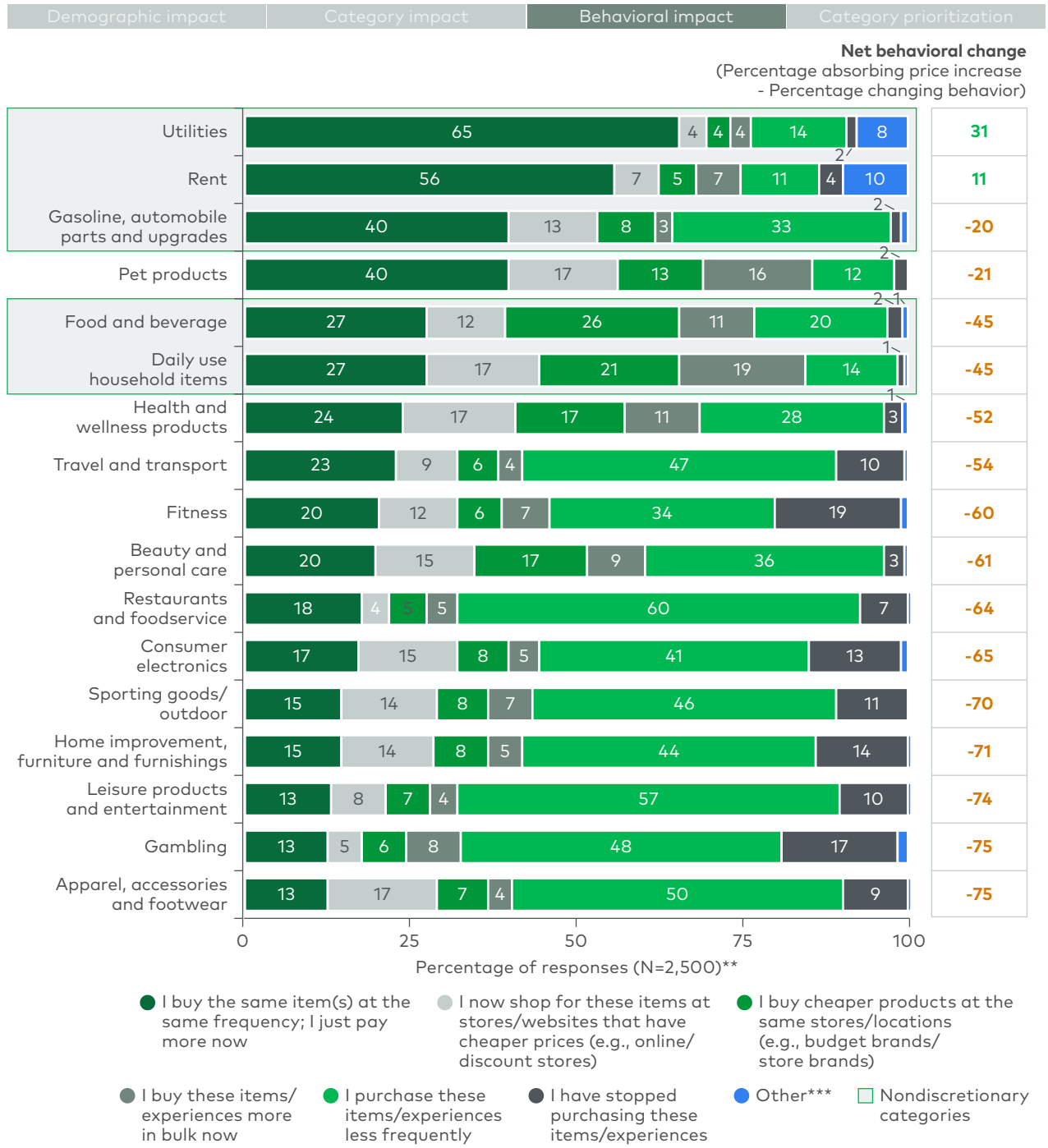
Figure 11
Inflation impact on consumer behavior



BPC=beauty and personal care; F&B=food and beverage; H&W=health and wellness
Source: L.E.K. research and analysis

Indeed, inflation has been prompting consumers to make significant changes to their spending patterns, especially in those categories that are discretionary. Inflation is being mostly absorbed by the end user in only the most necessary nondiscretionary categories — rent and utilities — and to a lesser degree in motor vehicles and pet products.

Figure 12
Behavioral impacts on key categories

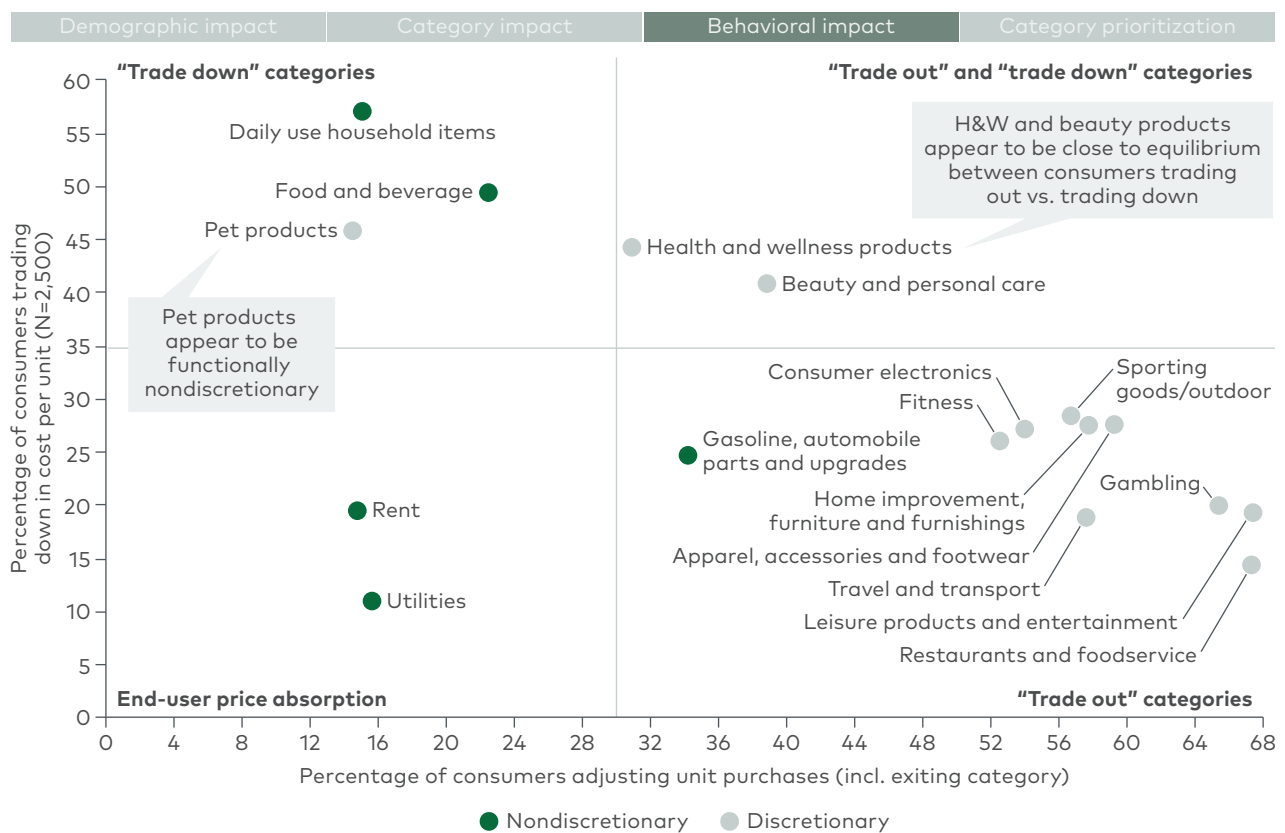


*Survey question: How much has inflation impacted the following products you have purchased in the past 12 months?
 **Percentages may not add to 100 due to rounding
 ***Other includes write-in responses, which largely consist of one-off solutions (e.g., I decided to move in with roommates within rent category)
 Source: L.E.K. survey and analysis

Consumers are trading down or otherwise adjusting their spending behaviors – but continuing to spend money – in the categories of daily household items, pet products, food and beverages, health and wellness, and beauty and personal care. But they are exhibiting more trade-out or delayed purchasing behaviors in every other discretionary category, in particular leisure, travel, restaurants, and apparel and footwear. In nondiscretionary categories, on the other hand, for the most part inflation is being acutely felt by consumers, but they aren't as likely to spend less in those categories. In the meantime, the amount of disposable income consumers have relative to what they spend continues to shrink, potentially exacerbating these behaviors.

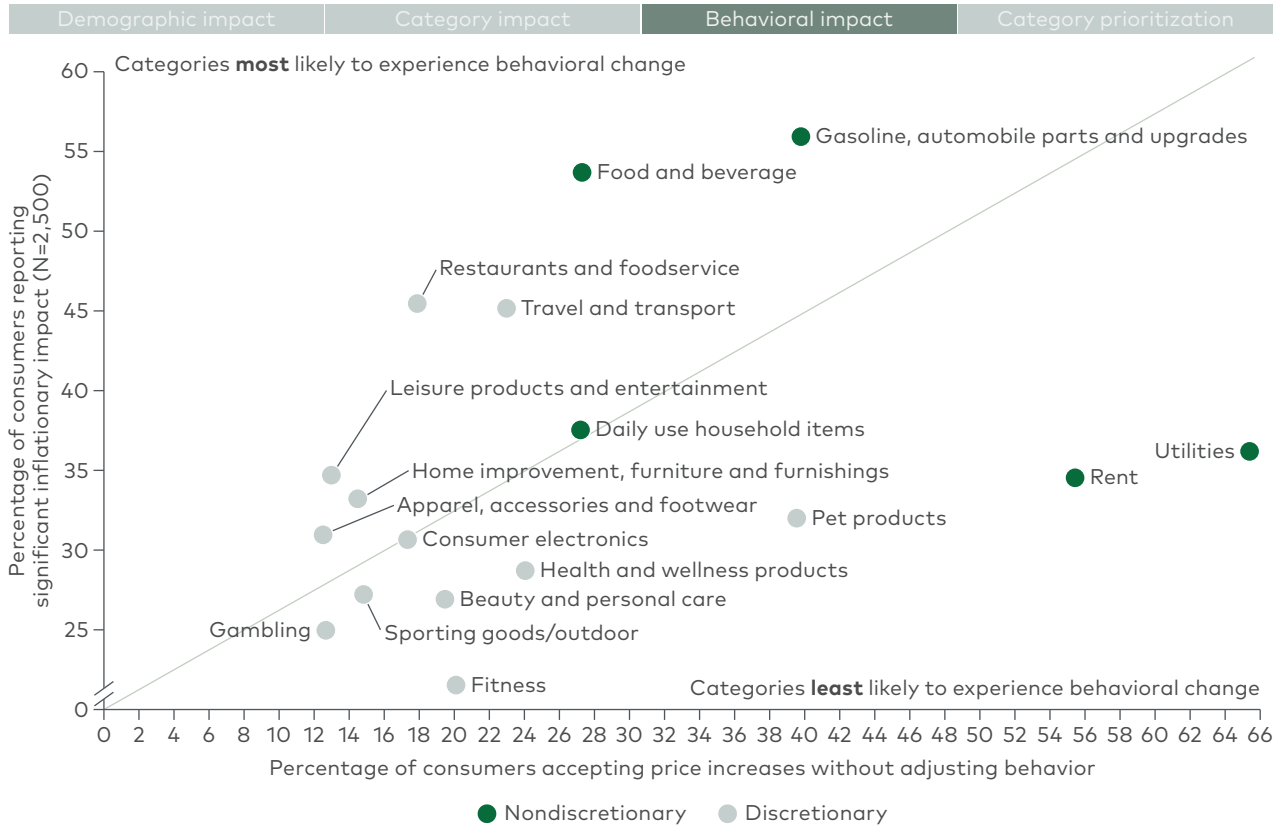
Only a small portion of consumers are absorbing price increases in restaurants and apparel without adjusting their behavior. But interestingly, younger cohorts are more inclined to behave in that way relative to their, on average, lower incomes, especially

Figure 13
Behavioral impacts x perceived pricing impacts on key categories



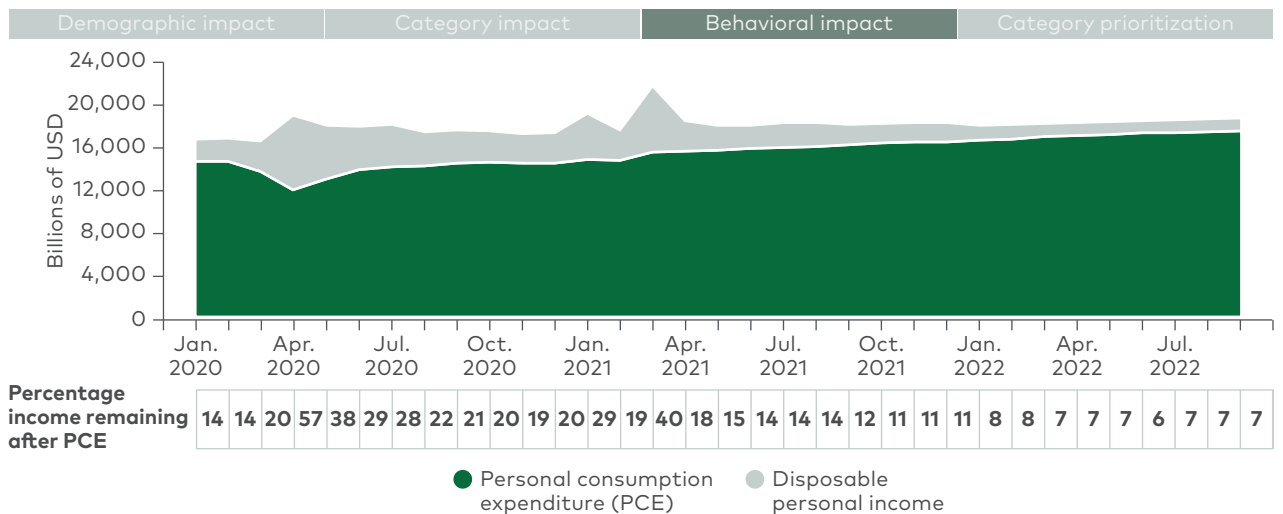
*Survey question: How much has inflation impacted the following products you have purchased in the past 12 months?
Source: L.E.K. survey and analysis

Figure 14
Behavioral impacts x perceived pricing impacts on key categories



*Survey question: How much has inflation impacted the following products you have purchased in the past 12 months?
Source: L.E.K. survey and analysis

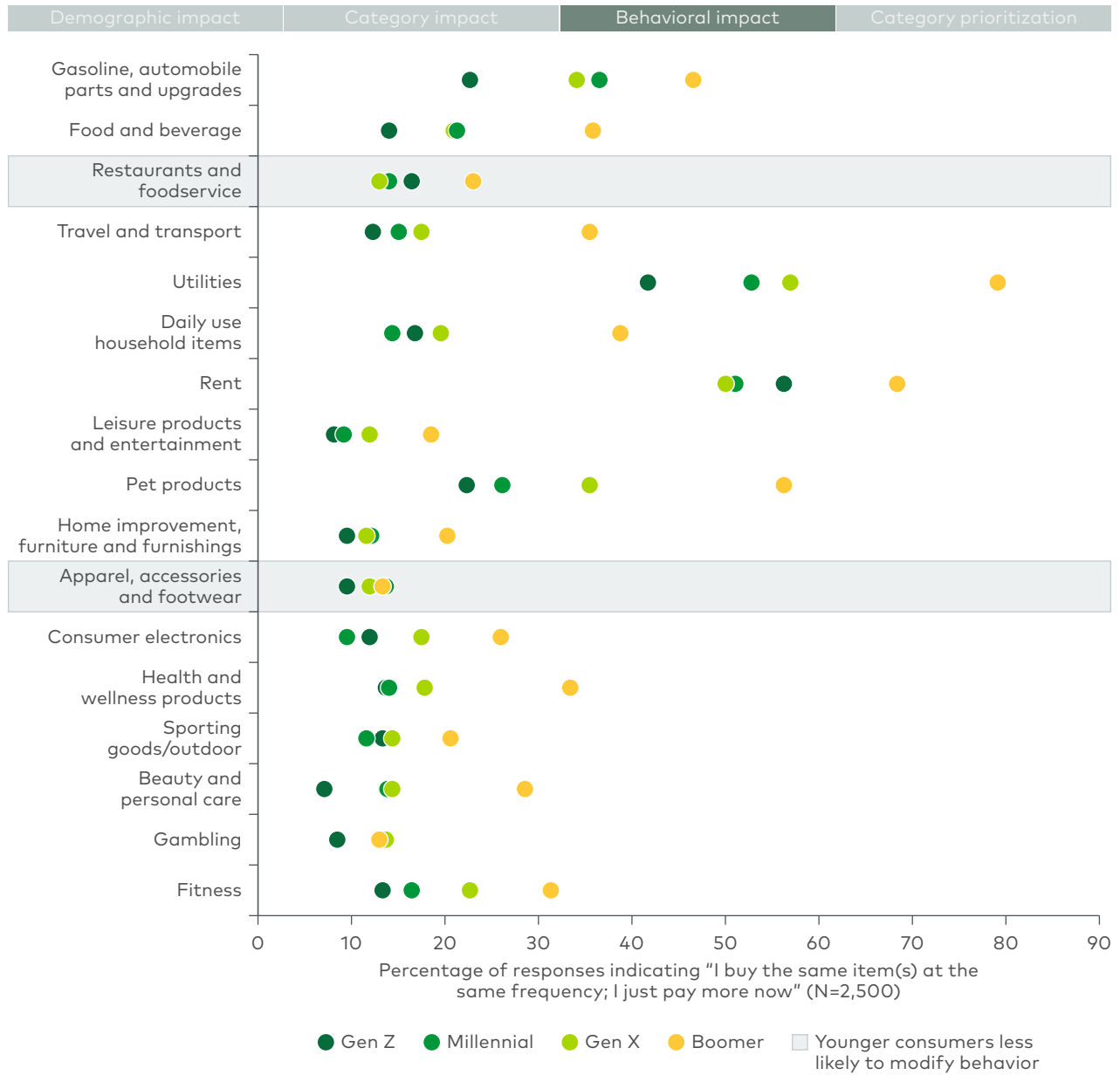
Figure 15
Disposable personal income and personal expenditure over time (1/2020-9/2022)



Source: BEA; L.E.K. research and analysis

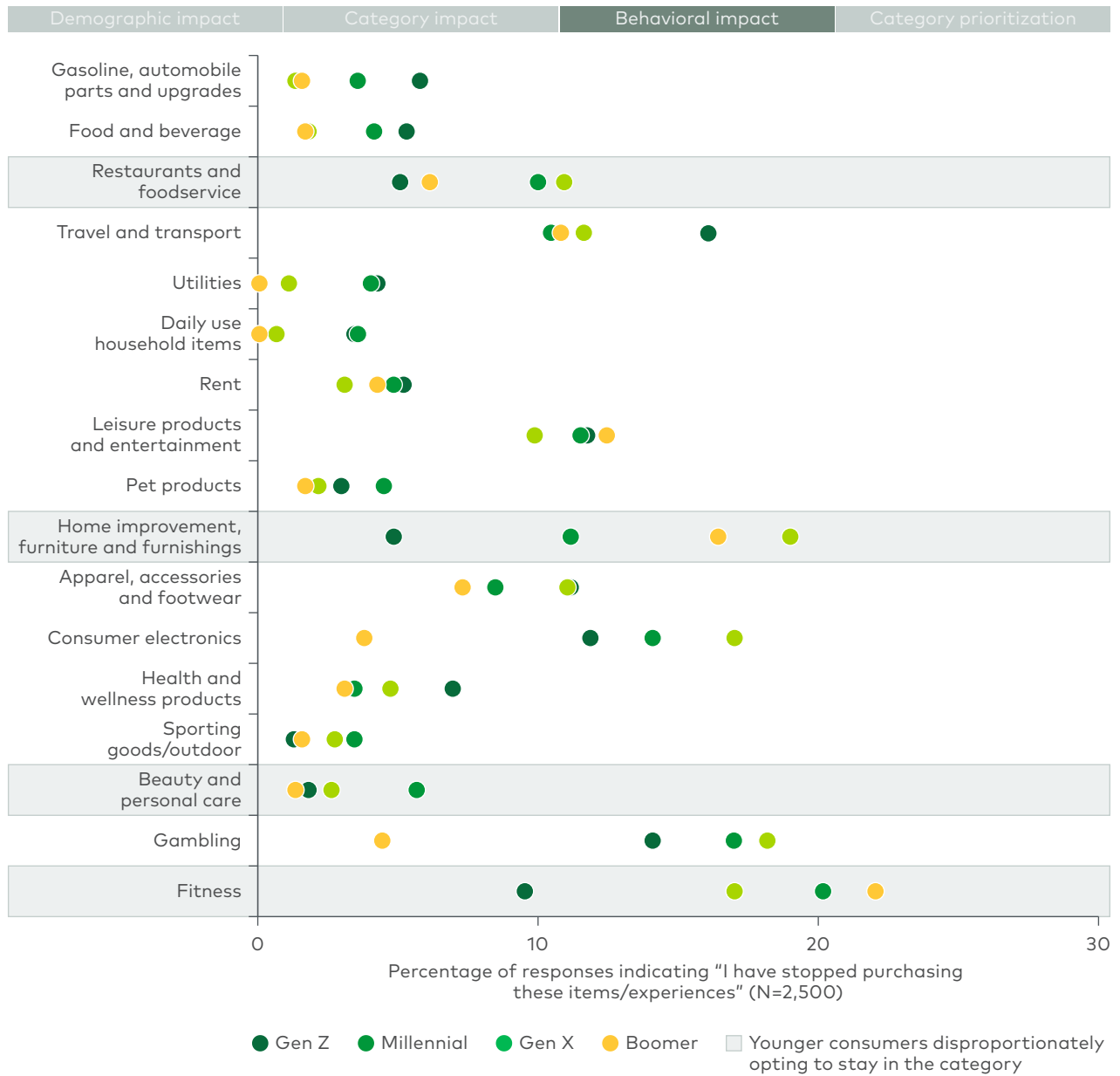
compared to boomers. Indeed, despite having lower incomes, younger consumers, especially Gen Z, are less likely to give up fitness, beauty and leisure activities, choosing to adjust their behavior before exiting those categories. This further demonstrates the persistent trend among younger U.S. consumers of valuing experiences over goods.

Figure 16
Behavioral impacts on key categories, by generational cohort



*Survey question: How much has inflation impacted the following products you have purchased in the past 12 months?
Source: L.E.K. survey and analysis

Figure 17
Behavioral impacts on key categories, by generational cohort



*Survey question: How much has inflation impacted the following products you have purchased in the past 12 months?
Source: L.E.K. survey and analysis

How consumers prioritize categories if inflation persists or abates

Across the board, consumers primarily want to reverse trade-down behaviors and return to spending on their preferred "standard of living" items: food and beverage, rent, and daily household use items. As to discretionary spend categories, travel and transport, restaurants, and apparel top the list.

Figure 18
Future behavioral impact expectations, by category



*Survey question: You indicated that your purchase behavior for [category] changed in response to inflation; if prices stop increasing, do you expect to return to the same channels/brands that you used previously?

**Percentages may not add to 100 due to rounding

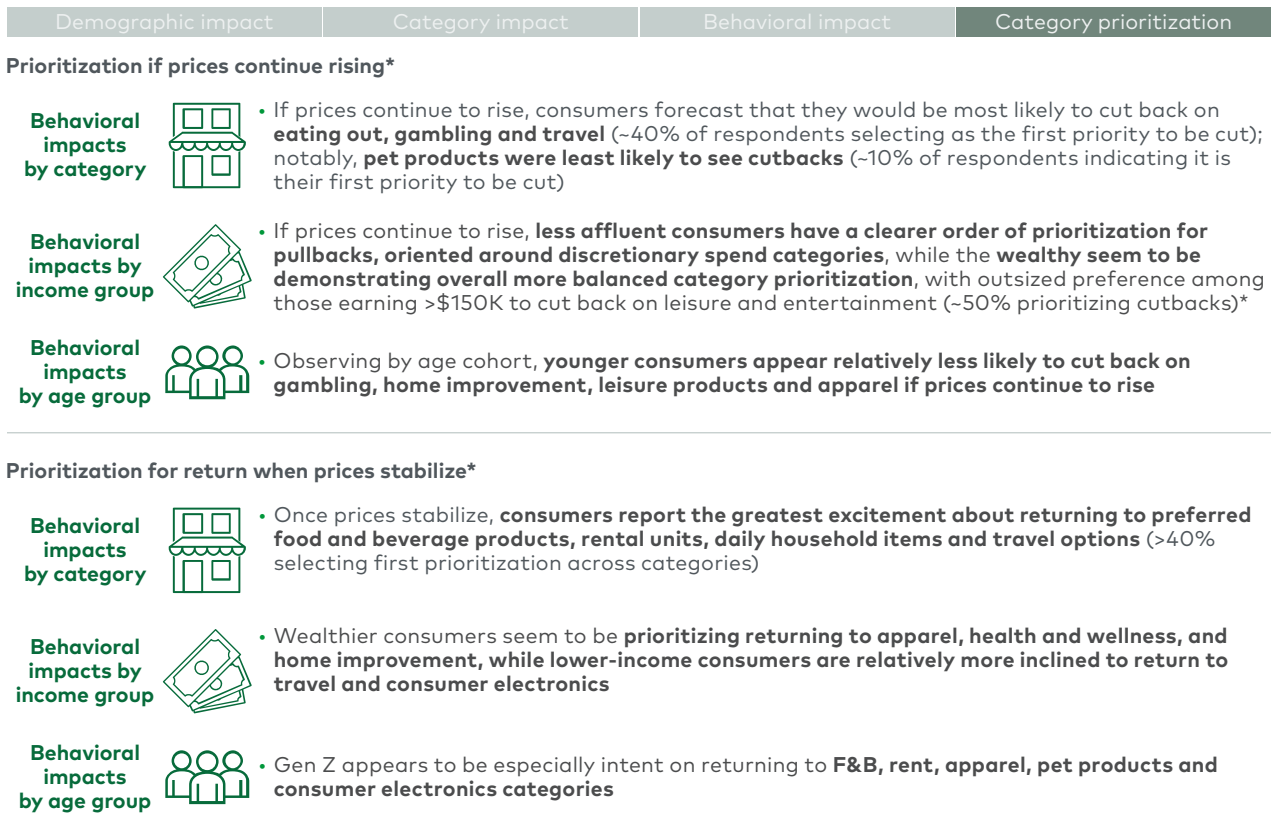
Source: L.E.K. survey and analysis

If prices continue to rise, eating out, gambling and travel will be the top three categories that consumers will cut back on. Home furnishings, electronics and other discretionary durables like apparel and footwear would also see additional pressure. Pet products, meanwhile, are least likely to see any reduced spending in that case.

Those priorities shift even further across demographics. Even if prices continued to climb, younger consumers would be less likely to cut back on gambling, home improvement, leisure products and apparel.

Conversely, once prices stabilize, preferred food and beverage products, housing/ rental units, daily household items and travel options are the categories consumers are most excited about spending their money on.

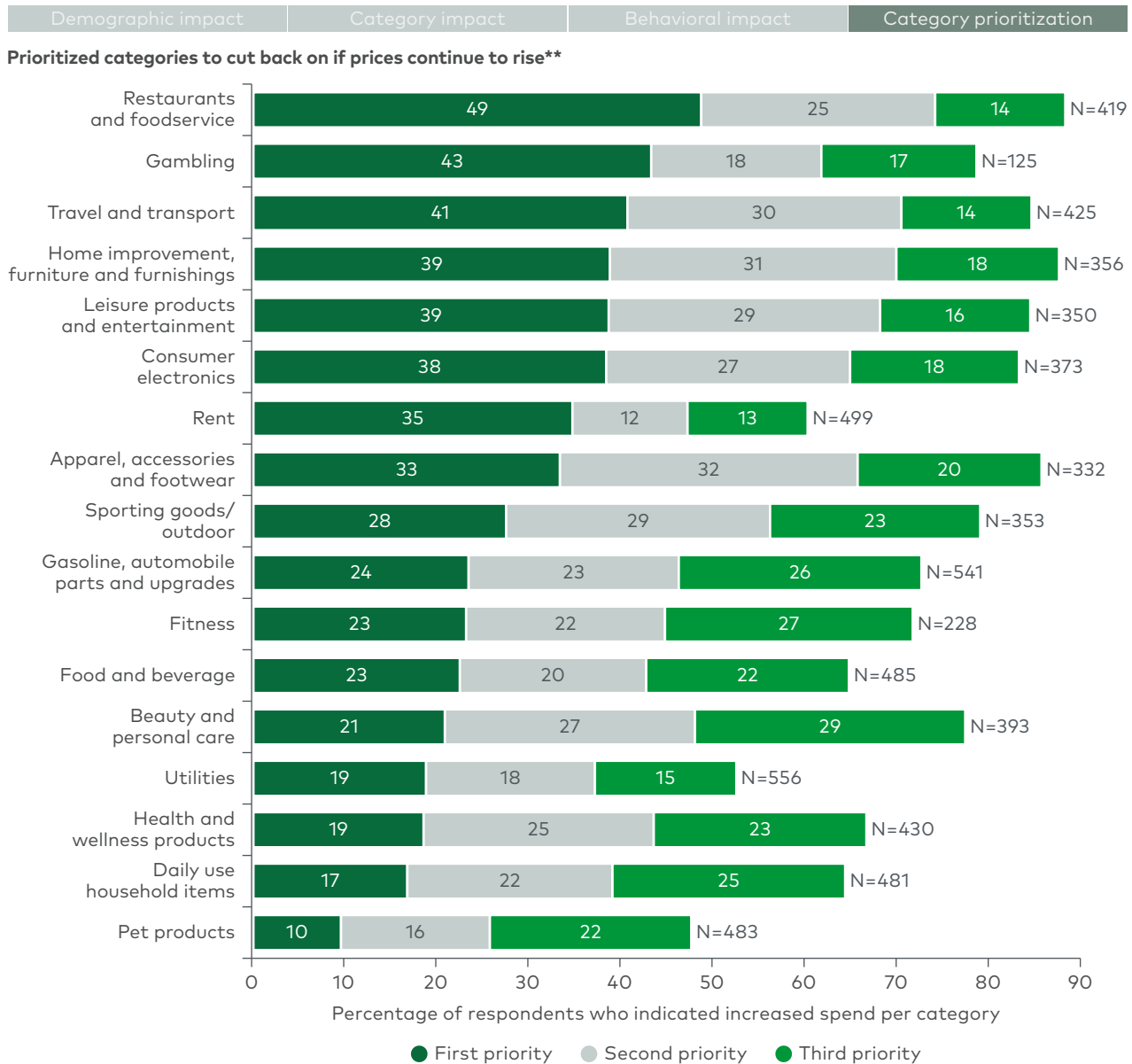
Figure 19
Consumer forecasted changes in category consumption based on direction of prices



*Consumers who reported increased spending in a category were shown a maximum of five categories to compare preferences
F&B=food and beverage
Source: L.E.K. research and analysis

Figure 20

Consumer expectations for changes to category consumption if inflation persists



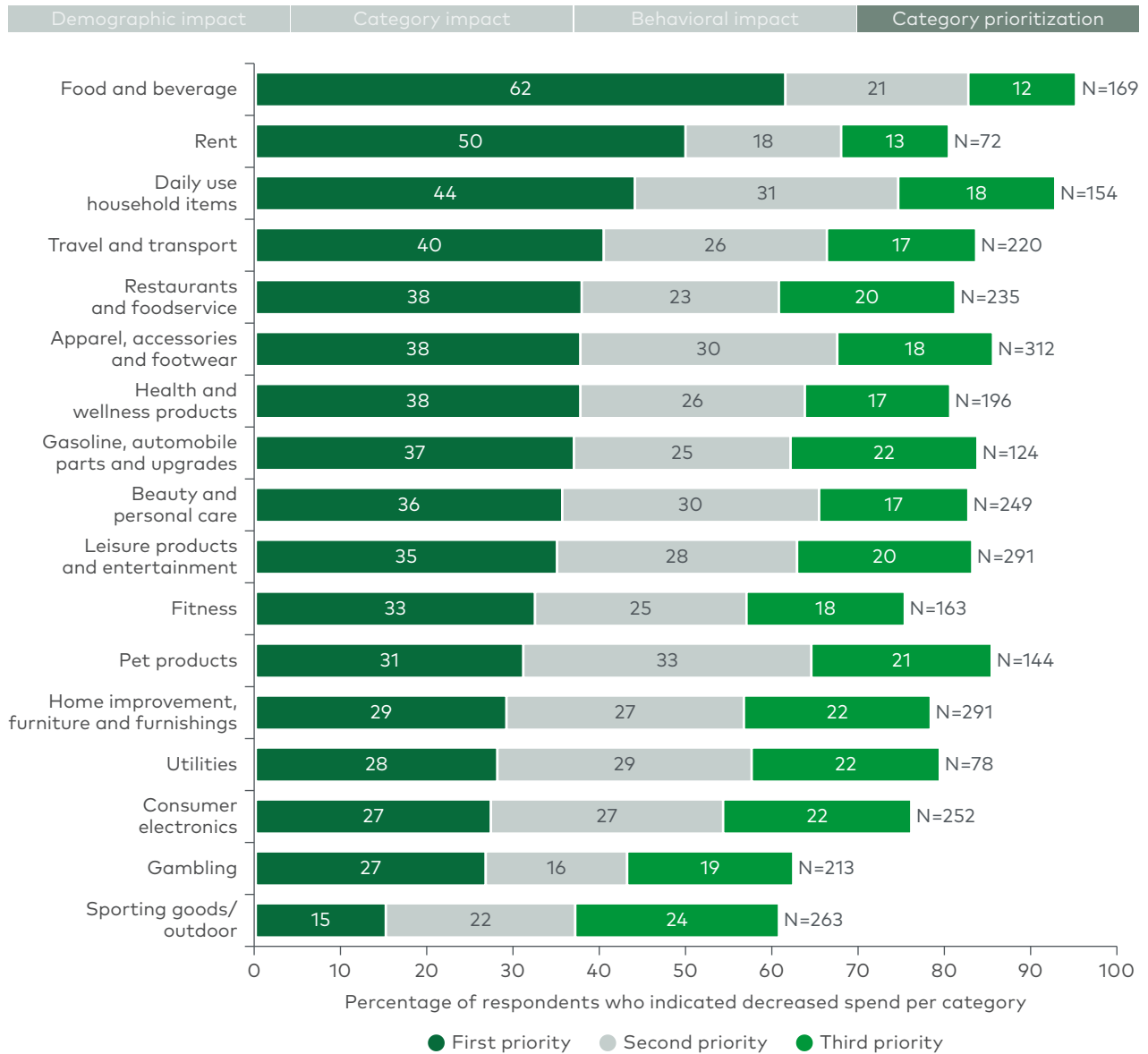
*Survey question: Among categories where you reported an increase in relative spend, please rank the categories you are most likely to cut back on if prices continued to rise

**Consumers who reported increased spending in a category were shown a maximum of five categories to compare preferences

Source: L.E.K. survey and analysis

When looked at through the lens of income, if inflation continues, less affluent consumers will cut back in discretionary spend categories while wealthy consumers will take a more balanced approach, focusing on apparel, health and wellness, and home improvement.

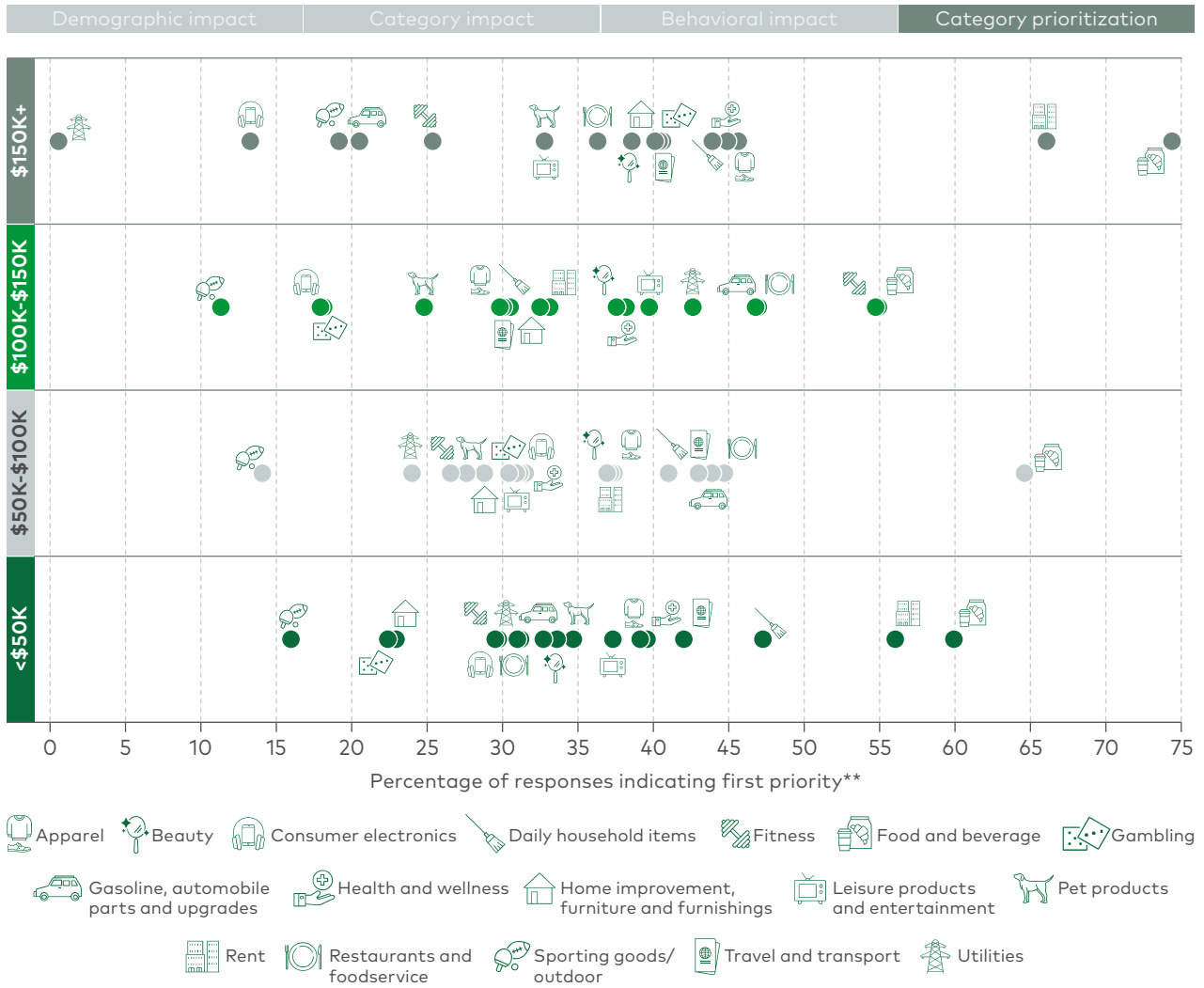
Figure 21
Prioritized categories to return to when prices stabilize**



*Survey question: Which of the following categories are you most likely to return to old purchasing habits first, if/when pricing stabilizes? (Please rank the top three)
 **Consumers who reported increased spending in a category were shown a maximum of five categories to compare preferences
 Source: L.E.K. survey and analysis

But once prices stabilize, wealthier consumers will focus on apparel, health and wellness, and home improvement, while those with lower incomes will resume their spending on travel and consumer electronics.

Figure 22
Consumer prioritization of product categories if pricing stabilizes, by income



*Survey question: Which of the following categories are you most likely to return to old purchasing habits first, if/when pricing stabilizes? (Please rank the top three)

**When shown five choices on a least fill basis

Source: L.E.K. survey and analysis

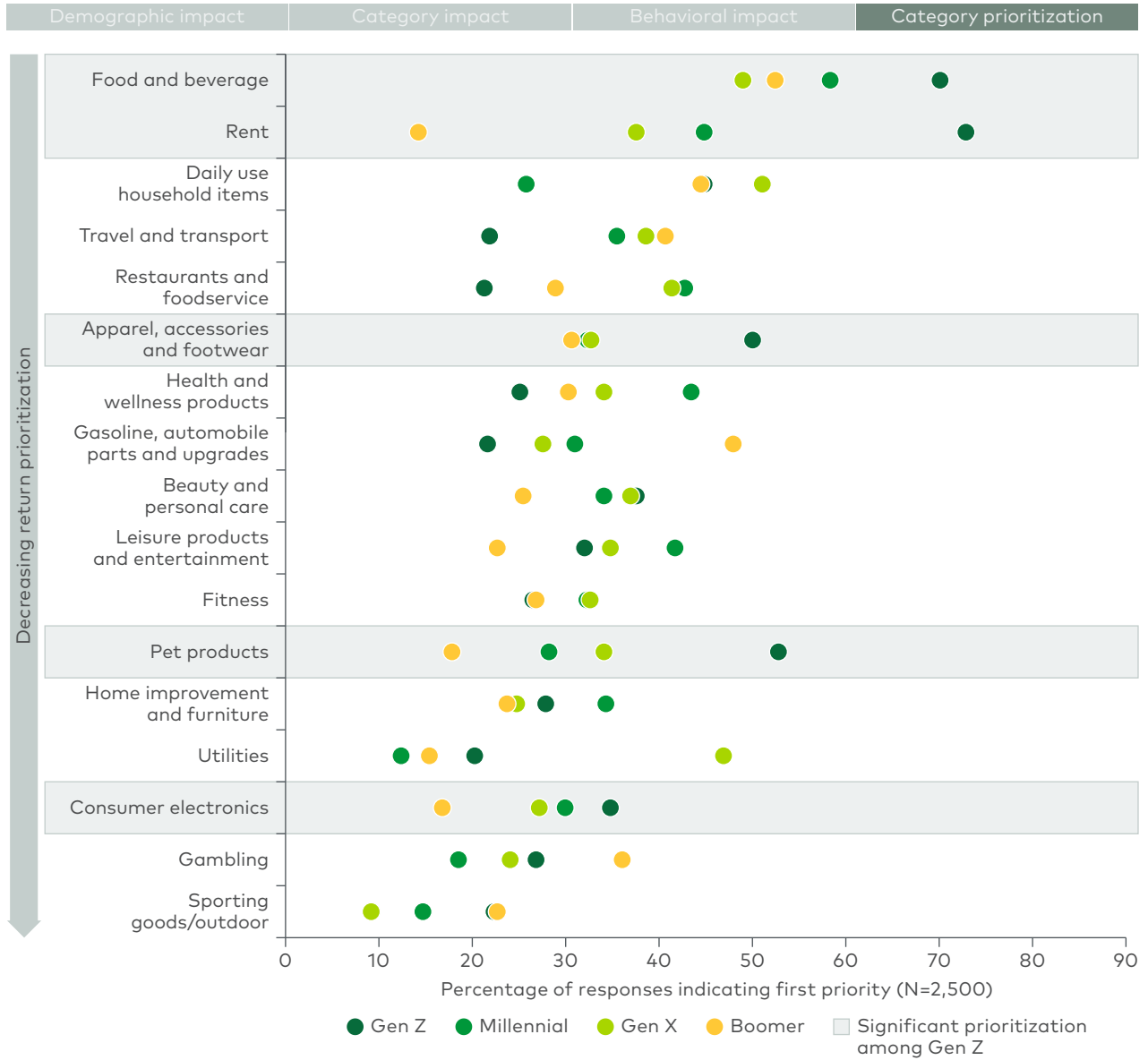
Figure 23
Consumer prioritization of product categories if inflation persists, by income



*Survey question: Among categories where you reported an increase in relative spend, please rank the categories you are most likely to cut back on if prices continued to rise
 **When shown five choices on a least fill basis
 Source: L.E.K. survey and analysis

Gen Z, meanwhile, is especially intent on returning to spending in food and beverage, rent, apparel, pet products, and consumer electronics.

Figure 24
 Prioritized categories to return to when prices stabilize, by generational cohort



*Survey question: Which of the following categories are you most likely to return to old purchasing habits first, if/when pricing stabilizes? (Please rank the top three)
 Source: L.E.K. survey and analysis

Conclusion

As American consumers grapple with a level of inflation many of them have never even imagined much less experienced, they are adjusting their spending — and related behaviors — accordingly. But those adjustments differ depending on age, income level and the category in which consumers are spending. And those behaviors will continue to shift, whether inflation continues to climb or, ideally, starts to retreat.

We invite you to connect with us to learn more about our survey and how particular consumers are adjusting their spending habits now or plan to adjust them going forward. Please don't hesitate to contact us.

For more information, please contact strategy@lek.com.



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